McINTYRE MINES LIMITED

67th ANNUAL REPORT 1978

ANNUAL AND GENERAL MEETING

McINTYRE MINES LIMITED

The Annual and General Meeting of Shareholders will be held at 10:00 o'clock a.m. (Toronto Time) on Monday, April 23, 1979, in the Territories Room, Royal York Hotel, Toronto, Ontario.

CONTENTS

Capital Stock

Authorized: 3,000,000 shares without par value
Issued: 2,434,482 shares

Location of Mines

McIntyre Coal Division, Grande Cache, Alberta
The Madeleine Mine, Ste. Anne des Monts, Quebec

Executive and Head Office

Suite 5100, Commerce Court West
Toronto, Ontario M5L 1C1

Auditors

Price Waterhouse & Co.
Chartered Accountants, Toronto, Ontario

Transfer Agents

Canada Permanent Trust Company, Toronto, Ontario
and Calgary, Alberta
Bradford Trust Company, New York, N.Y.

Registrars

Crown Trust Company, Toronto, Ontario and Calgary, Alberta
The Chase Manhattan Bank (National Association), New York, N.Y.

Stock Exchanges

The stock of the Company is listed for trading on the Toronto Stock Exchange and the New York Stock Exchange.

McINTYRE MINES LIMITED

Directors

*M. A. COOPER Toronto, Ontario	*President and Managing Director* *Falconbridge Nickel Mines Limited*
*A. E. FELDMEYER Toronto, Ontario	*President and Chief Executive Officer* *McIntyre Mines Limited*
**R. B. FULTON	*Former President and Chief Executive Officer* *McIntyre Mines Limited* **(deceased, August 19, 1978)
*H. B. KECK Houston, Texas	*Chairman of the Board of the Company and* *Chairman of The Superior Oil Company*
W. M. KECK, JR. Los Angeles, California	*Director* *The Superior Oil Company*
SENATOR, THE HON. E. C. MANNING, P.C., C.C., LL.D. Edmonton, Alberta	*Chairman* *Manning Consultants Limited*
† A. R. NIELSEN Calgary, Alberta	*President and Chief Executive Officer* *Canadian Superior Oil Ltd.*
†* L. T. POSTLE Vancouver, B.C.	*Consulting Engineer*
†* J. B. REDPATH Toronto, Ontario	*Director* *Dome Mines Ltd.*

* Member of the Executive Committee

† Member of the Audit Committee

Officers

H. B. KECK, *Chairman of the Board*
A. E. FELDMEYER, *President and Chief Executive Officer*
J. J. CROWHURST, *Vice-President Operations*
F. T. MCKINNEY, *Vice-President Corporate Affairs and Secretary*
D. G. PAGE, *Treasurer*
D. G. PITTET, *Assistant Secretary and Corporate Counsel*
J. O. KACHMAR, *Comptroller and Assistant Treasurer*

Operations

Coal Division R. F. LAMBERT, *General Manager, Grande Cache, Alberta*

Madeleine Mine J. FAUBERT, *Assistant General Manager, Ste. Anne des Monts, Quebec*

Coal Sales J. C. MCCARTHY, *Director, 230 Park Avenue, Ste. 610, New York, N.Y.*

McINTYRE MINES LIMITED

DIRECTORS' REPORT

To the Shareholders:

Depressed and unsettled conditions in the world's economies and in particular, the continuing weakness in metallurgical coal markets, seriously affected the Company's performance in 1978. For the year, a loss from operations of $1.2 million was sustained compared with a profit of $8.8 million for 1977. Including deferred income taxes and equity in the results of the Company's affiliates Falconbridge Nickel Mines Limited and Madeleine Mines Ltd., and non-recurring items, a consolidated loss of $1.02 million ($.43 share) resulted compared with a consolidated loss, restated to reflect the capitalization of certain equipment leases, of $15.61 million ($6.59 share) for the previous year.

Net revenue from the sale of 1.527 million long tons of the Company's Smoky River coal in 1978 totalled $101.2 million compared with $118.8 million from the production of 1.740 million long tons in the previous year; sales revenues being recognized on a coal sales basis in 1978 as compared to a production basis in 1977. Operating costs at $76.7 million were lower than the previous year's costs of $90.6 million.

Off-site exploration expenditures at $4.3 million were approximately $1 million greater than those of 1977 and debt service costs at $6.3 million were approximately $2 million greater than the previous year's $4.3 million due to higher bank interest rates. Amortization charges declined by $1.6 million to $1.9 million attributable to a lower throughput of raw coal in 1978 and a change in the product ratio from producing mines. To reduce bank interest costs, $31.6 million U.S. currency was borrowed in February, 1978 by the conversion of $35 million of the Canadian bank loan when the Canadian dollar was trading at 90¢ U.S. By year's end, the Canadian dollar had depreciated by a further 6¢ U.S., resulting in a charge against income of $2.4 million representing a provision for possible future loss on foreign exchange. The Canadian dollar bank loan was reduced during the year to $27.6 million and total bank indebtedness stood at $65.1 million at December 31, 1978 compared with $67.3 million a year ago. Included as an extraordinary credit in the year's accounts is $1.5 million being proceeds from the compulsory surrender of certain non-productive Crown coal leases.

Capital expenditures during 1978 were $9.3 million compared with $21.1 million in 1977.

Dividends of 25¢ per share were paid on March 6, and June 1, 1978 but have since been temporarily suspended to conserve cash and reduce indebtedness.

OPERATIONS

Smoky River Coal Division

During the year 1.24 million long raw tons of coal were mined from underground and 891,000 tons were mined from surface operations compared with 1.27 million tons and 1.67 million tons respectively, in 1977.

The coal preparation plant processed 2.03 million long tons compared with 2.8 million tons a year ago. The clean coal yield, after allowances for breaker rejects, averaged 65.5% in 1978 compared with 64.1% in 1977. Deliveries to the H. R. Milner Generating Plant of Alberta Power Limited were 138,000 long tons of fuel from the tailings dewatering plant, 8,000 tons of non-coking coal and 409,000 tons of primary discards from the coal preparation plant.

Clean coal inventories at December 31, 1978 totalled 186,000 long clean tons.

Coal production costs were reduced through increased productivity in all departments.

A three-year collective labour agreement between the Company and Local 7621, United Steelworkers of America, which was negotiated in 1978 was ratified in early January of 1979. It provides for a 9% increase in wages during 1979, 8% during 1980 and 7.23% in 1981, plus minor improvement in fringe benefits.

During 1978, all contractual coal tonnages were delivered on schedule and to specifications. Deliveries, in long tons, to the Japanese buyers were 1,103,000 and those to the Company's Canadian customers, Dofasco and Sydney Steel, were 189,000 and 126,000 respectively. Shipments to South America and Korea totalled 109,000 long tons.

No. 2 mine — No. 10 Seam at Smoky River was placed on a "care and maintenance" basis in mid-September pending re-evaluation of suitable mining methods.

Both development and depillaring work was conducted in No. 2 mine – No. 11 Seam at Smoky River during the year.

In the Reiff Terrace mine – No. 2R-4 Seam, development work was stopped late in 1978 approximately 4,800 feet from the entry portals in view of excessive rolls encountered in the coal seam. Depillaring was then extended to cover a general retreat throughout the whole of the Reiff Terrace mine – No. 4 Seam, towards surface.

A new mine, Reiff Terrace – No. 11 Seam, has been started and a small amount of development was carried out in 1978 to establish it as an alternative producing mine should the need arise.

At No. 9 surface mine the waste removal from the Western Extension was carried down to the top of the anticline in No. 4 coal seam exposing large amounts of coal. Advance waste stripping was also initiated in the second or more westerly phase of the West Extension in conformance with long range mining plans.

Total waste removed in No. 9 mine during 1978 was 11,207,000 cubic yards compared with 19,411,000 cubic yards during 1977. The reduction was commensurate with the raw coal requirements for 1978.

Comparative waste to coal ratios for 1976, 1977 and 1978 were 10.20 to 1; 11.62 to 1 and 12.60 to 1.

Copton Excol Ltd.

The Company remained inactive throughout the year. The lawsuit between Meadowlark Farms Inc., a subsidiary of Amax Inc. and Copton Excol and McIntyre as described in the notes to the December 31, 1978 financial statements, has not yet come to trial.

Falconbridge Nickel Mines Limited

Consolidated earnings for the year 1978 were $5,500,000 compared with a consolidated loss in 1977 of $29,223,000 before an extraordinary gain of $20,238,000 realized from the sale of shares of Alminex Limited. The loss in 1977 after the extraordinary item was $8,985,000. After providing for preferred share dividends, the consolidated earnings in 1978 were equal to 15 cents per convertible Falconbridge share compared with a 1977 loss of $6.23 per convertible share before the extraordinary gain and $2.15 per convertible share after such gain. The low level of earnings in 1978 was attributable mainly to the general weakness in the demand for nickel products and severe price competition in the nickel industry.

The Integrated Nickel Operations contributed earnings of $6,443,000 in 1978 compared with a loss of $21,629,000 in the previous year. Sales of refined nickel were more than double the volume sold in 1977. Copper sales volume was 30 per cent lower than in 1977, reflecting the production cutbacks from Sudbury ores. Prices for nickel declined sharply during 1978 while copper and cobalt prices strengthened. Since most of the Company's production is sold in United States currency, the weakness of the Canadian dollar relative to the U.S. dollar continued to have a favourable impact on revenues. Notwithstanding the beneficial effect of such gains on currency exchange, the selling price of nickel products in Canadian currency was sharply lower in 1978 than in the previous year. The unit costs of production at both the Sudbury Operations and the Norwegian Refinery have increased over those of 1977 because of lower levels of production, higher labour rates and the increased cost of fuel and supplies. The stronger Norwegian kroner had an additional unfavourable impact on refinery costs.

The contribution to consolidated earnings from subsidiary companies in 1978 increased from $3,765,000 in 1977 to $4,549,000. The 1978 contribution from Falconbridge Copper Limited was $7,498,000, an increase of $4,585,000 over that of the previous year. Indusmin Limited contributed $2,027,000, up $776,000 from 1977. Wesfrob Mines Limited contributed $551,000 and Oamites Mining Company (Proprietary) Limited contributed $405,000 compared with losses of $2,211,000 and $336,000 respectively in 1977. A loss of $6,596,000 in respect of Falconbridge Dominicana is included in consolidated results compared with an earnings contribution of $2,788,000 in 1977.

Madeleine Mines Ltd.

Following suspension of mining and milling operations at the end of 1976, the mine and surface plant have been maintained on a standby basis. The net loss for 1978 totalled $729,000 and working capital at year's end, consisting chiefly of cash and short-term investments, totalled $782,000. It is expected that current improvement in the price of copper will enable the Madeleine mine to be reopened later in the year for a limited period of operation.

EXPLORATION

Off-site exploration expenditures during 1978 totalled $4.3 million compared with $3.2 million for 1977. Expenditures by the Company and its joint-venture partners on various projects in which the Company participates totalled $12.0 million compared with $7.9 million for 1977. Major exploration emphasis for 1978 was in Alaska and Nevada and in Tasmania, Australia.

Many areas of mineralization were examined in 1978 by the Doyon Joint Venture in Alaska. Extensive geochemistry, geological mapping and limited geophysics were carried out on several prospects and limited core drilling was also conducted. More than twenty promising areas have been delineated as being worthy of further detailed exploration. McIntyre Mines Limited has joined with the other four participating companies in an extension of the Doyon Agreement to cover work planned for 1979 the cost of which is estimated at $800,000.

Under the terms of the Doyon Agreement, a Project Area was selected by McIntyre Mines Limited in early 1978 to explore hard rock gold possibilities in the vicinity of the placer workings at Flat, Alaska. A closely spaced grid drilling program has given some encouragement and further work is planned for 1979.

Extensive grid pattern diamond drilling was carried out on the "Core Shack Ridge" and other asbestos showings at the Eagle, Alaska, property in northeastern Alaska in which McIntyre holds an interest. Metallurgical investigations have been conducted on core samples obtained from the 1978 drilling, with favourable results. A second promising area was located a few miles to the east of the original discoveries by Alaska Asbestos field crews late in 1978. Plans have been made to undertake further grid drilling on the new showing during 1979.

Exploration diamond drilling was carried out on the Nightingale tungsten project northeast of Reno, Nevada, with indifferent results.

The Cordex Syndicate, in which McIntyre has a participating interest, continued prospecting and property evaluation work in the western Cordilleran of the United States. A large group of claims was acquired to cover uranium occurrences in northern Nevada and a drilling program was initiated. Further work is planned for 1979.

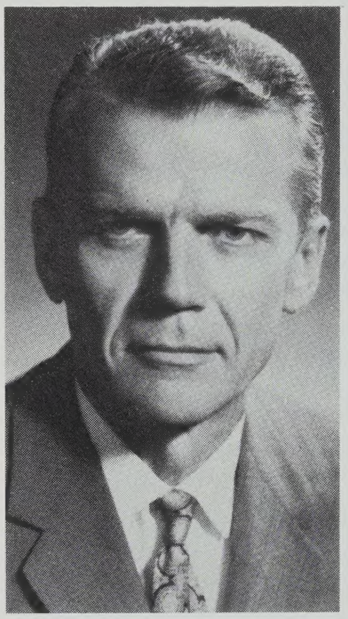
McIntyre has entered into an agreement with Tasminex N.L., whereby McIntyre can earn a 50% interest in a tungsten property in Tasmania near Burnie, a small town on the north central coast. The mineralization is characteristic of certain of the larger tungsten orebodies of the world. A diamond drilling program was carried out which outlined near surface mineralization. A preliminary feasibility study is underway.

Core drilling on the Quebrada Blanca property in northern Chile continued under the management of The Superior Oil Company and a program of diamond drilling on a grid pattern was completed in the first phase of exploration. Plans are being made for the second stage of exploration which will consist largely of underground work to permit bulk sampling planned for the late spring of 1979.

Several properties with gold bearing potential were examined in British Columbia and an option was secured on the Prosperpine property in the Cariboo district. Preliminary work conducted in late 1978 will be followed by a limited diamond drilling program in 1979.

Because of the Company's burdensome financial condition, most of its exploration expenditures are being curtailed. Under arrangements not yet completed, work on the more important projects will be carried on by other interested parties with the Company retaining interests therein through appropriate dilution formulae.

ROBERT BERTHEAU FULTON



The directors record with deep regret the death on August 19, 1978 of the Company's former President and Chief Executive Officer, Robert B. Fulton, a director of the Company since May 10, 1972. Mr. Fulton's dedicated service to the Company, his contributions to the deliberations of the Board of Directors and his advice during the years he served the Company were highly valued and respected.

MANAGEMENT

On August 11, 1978 Howard B. Keck, a director of the Company since February 5, 1969 was appointed Chairman of the Board of Directors and A. E. Feldmeyer, a director since May 3, 1967 was elected President and Chief Executive Officer. At the same meeting F. T. McKinney, formerly Corporate Secretary of the Company was appointed Vice President Corporate Affairs and Secretary. J. J. Crowhurst, formerly General Manager of the Company's Coal Division, was appointed Vice President Operations on April 24, 1978 and to further strengthen the management team, E. J. Bethell was appointed later in the year as Assistant to the President, D. G. Pittet was appointed Assistant Secretary and Corporate Counsel and J. O. Kachmar was appointed Comptroller and Assistant Treasurer. In strengthening the marketing arm for the Company's products, Jerome C. McCarthy was engaged as Director of Coal Sales. Mr. McCarthy, well known internationally in coal mining and marketing circles, continues to be based in New York City.

OUTLOOK

Although intensified efforts are being made to further diversify, develop and expand the metallurgical coal markets available to McIntyre, those markets, reflecting the difficulties which presently beset the world's economies, are for the greater part characterized by heightened competition and depressed steel output. At December 31, coal contracts for deliveries in 1979 totalled 175,000 long clean tons and at the time of writing, final negotiations with the Company's Japanese consumers for supplies in the 1979 contract period, which begins on April 1st, had not commenced. The outlook for 1979 is, therefore, one of uncertainty and until demand for the Company's Smoky River coal increases substantially, particularly in Japan, lowered sales volume coupled with marginal prices does not augur well for the Company's profit picture. In the meantime, cost-cutting measures continue to be applied to all of the Company's operations and capital and off-site exploration expenditures will be held to a minimum. These measures should enable McIntyre to remain competitive and prepared to participate with offerings of metallurgical coal whenever and wherever sales opportunities can be identified.

Re-negotiation of the Company's bank line of credit, which has not yet been finalized, commenced with termination of the former banking arrangement in early 1979 and studies designed to reduce interest carrying charges through lower cost financing are in progress.

McIntyre's employees continued to demonstrate resourcefulness and dedication during this difficult period and the Government of the Province of Alberta has been of immeasurable assistance and support. To all of them, McIntyre's directors and officers express their grateful thanks.

On behalf of the Board of Directors

A. E. Feldmeyer

A. E. Feldmeyer
President

Toronto, February 22, 1979

AUDITORS' REPORT

Price Waterhouse & Co.
CHARTERED ACCOUNTANTS

Box 51 Toronto-Dominion Centre
Toronto, Ont. M5K 1G1
(416) 863-1133 Telex 065-24111

February 22, 1979

To the Shareholders of
McIntyre Mines Limited

We have examined the consolidated balance sheet of McIntyre Mines Limited as at December 31, 1978 and the consolidated statement of earnings, reinvested earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. The investment in Falconbridge Nickel Mines Limited has been accounted for on the equity basis, and we have relied on the report of the auditors who have examined its financial statements.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles on a basis consistent with that of the preceding year, after giving retroactive effect to the change in accounting for equipment under capital lease referred to in note 1(c) to the financial statements.

Price Waterhouse & Co.

Chartered Accountants

McINTYRE MINES LIMITED

AND SUBSIDIARY COMPANIES
(Incorporated under the laws of the Province of Ontario)

CONSOLIDATED BALANCE SHEET

($000's omitted)

Assets

	DECEMBER 31 1978	1977 (restated)
Current		
Accounts receivable (Note 2)	$ 6,721	$ 2,107
Inventories and mine supplies (Note 3)	16,778	27,475
	23,499	29,582
Investments (Note 4)		
Falconbridge Nickel Mines Limited	99,732	99,635
Madeleine Mines Ltd.	556	1,163
	100,288	100,798
Properties and Plant		
Plant and equipment at cost (Note 5)	91,517	89,988
Less accumulated depreciation	37,067	28,445
	54,450	61,543
Deferred mine development less amortization (Note 6)	44,492	38,882
	98,942	100,425
Other		
Long-term account receivable	2,701	3,043
Employee housing loans	2,123	2,550
	4,824	5,593
	$ 227,553	$ 236,398

Liabilities and Shareholders' Equity

	December 31 1978	December 31 1977 (restated)
Current Liabilities		
Accounts payable	$ 7,042	$ 7,827
Accrued liabilities	5,218	7,228
Current portion of long-term debt	625	2,344
	12,885	17,399
Long-Term Debt less current portion (Note 7)	68,028	70,876
Deferred Income Taxes	2,806	2,094
Shareholders' Equity		
Capital stock (Note 12)		
Authorized — 3,000,000 shares without par value		
Issued — 2,434,482 shares	9,604	9,604
Reinvested earnings	138,007	140,213
	147,611	149,817
Less equity in own shares held by affiliate	3,777	3,788
	143,834	146,029
	$ 227,553	$ 236,398

Approved by the Board:

A. E. FELDMEYER, Director

A. R. NIELSEN, Director

McINTYRE MINES LIMITED

CONSOLIDATED EARNINGS

($000's omitted)

	YEAR ENDED DECEMBER 31 1978	1977 (restated)
Revenue (Note 1(b))		
Coal sales	$ 105,270	$ —
Coal production	—	123,873
Less coal royalty	(4,118)	(5,036)
	101,152	118,837
Dividends from affiliates	342	924
	101,494	119,761
Expenses		
Operating costs	76,661	90,584
Administration	2,000	863
Exploration	4,279	3,220
Interest (Note 1(f))	6,310	4,287
Depreciation	9,083	8,413
Amortization of deferred development	1,945	3,567
Provision for possible future foreign exchange loss	2,426	—
	102,704	110,934
Earnings (loss) from operations before deferred income taxes	(1,210)	8,827
Deferred income taxes (Note 8)	712	2,920
Earnings (loss) from operations	(1,922)	5,907
Reduction in undistributed earnings of affiliates	(554)	(12,599)
Loss before following items	(2,476)	(6,692)
Reduction in valuation of coal inventory to cost of production — net of deferred income taxes (Note 1(b))	—	(3,003)
Loss before extraordinary items	(2,476)	(9,695)
Extraordinary items (Note 9)	1,454	(5,915)
Consolidated loss	$ (1,022)	$ (15,610)
Per share (Note 10)		
Loss before following items	$ (1.04)	$ (2.82)
Reduction in valuation of coal inventory	—	(1.27)
Extraordinary items	0.61	(2.50)
Consolidated loss	$ (0.43)	$ (6.59)

CONSOLIDATED REINVESTED EARNINGS

($000's omitted)

	YEAR ENDED DECEMBER 31 1978	1977
Balance — beginning of year as previously reported	$ 141,011	$ 158,863
Adjustment for equipment under capital lease (Note 1(c))	(798)	(602)
As restated	140,213	158,261
Consolidated loss	(1,022)	(15,610)
	139,191	142,651
Dividends		
— current year — $0.50 per share (1977 — $1.00 per share) (Note 10)	(1,184)	(2,369)
— prior years	—	(69)
Balance — end of year	$ 138,007	$ 140,213

CONSOLIDATED CHANGES IN FINANCIAL POSITION

($000's omitted)

	YEAR ENDED DECEMBER 31 1978	1977 (restated)
Source of Working Capital		
Operations		
Loss before extraordinary items	$ (2,476)	$ (9,695)
Items not affecting working capital:		
Depreciation and amortization	11,028	11,980
Deferred income taxes	712	1,809
Provision for possible future foreign exchange loss	2,426	—
Reduction in undistributed earnings of affiliates	554	12,599
	12,244	16,693
Compensation for surrendered Crown leases	1,454	—
Reduction of long-term account receivable	342	320
Reduction of employee housing loans	427	41
Disposal of properties and other assets	—	460
Increase in bank financing	—	19,125
	14,467	36,639
Use of Working Capital		
Plant and equipment	1,723	13,897
Deferred mine development	7,602	7,158
Reduction of bank financing	4,650	—
Reduction of other long-term debt	625	1,898
Dividends paid to shareholders — current year	1,184	2,369
— prior years	—	69
Dividends paid on own shares held by affiliate (Note 10)	33	65
Other	219	—
	16,036	25,456
Increase (decrease) in working capital	$ (1,569)	$ 11,183
Working Capital Changes		
Increase (decrease) in current assets		
Accounts receivable	$ 4,614	$ (2,322)
Inventories and mine supplies	(10,697)	6,715
	(6,083)	4,393
Decrease in current liabilities		
Accounts payable and accrued liabilities	(2,802)	(3,072)
Current portion of long-term debt	(1,712)	(3,718)
	(4,514)	(6,790)
Increase (decrease) in working capital	$ (1,569)	11,183
Working capital — beginning of year	12,183	1,000
Working capital — end of year	$ 10,614	$ 12,183

McINTYRE MINES LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1978

1. **Accounting Policies**

(a) Principles of consolidation

The consolidated financial statements include the accounts of all companies which are more than 50% owned.

Investments in affiliated companies Falconbridge Nickel Mines Limited (37.1% equity interest) and Madeleine Mines Ltd. (36.4% equity interest) are accounted for by the equity method which reflects the Company's investment at cost plus its interest in undistributed earnings, less writedown in 1977 of $13,450,000 of which $11,300,000 relates to Falconbridge and $2,150,000 to Madeleine, because of the uncertainty in the recovery of underlying mining assets.

(b) Inventories

(i) Metallurgical coking coal
At December 31, 1977, the Company changed the basis of valuing its coal inventory from one of net realizable value to one of the lower of cost and realizable value, cost being determined on the basis of current production costs including depreciation and amortization of plant and properties. This change in basis of valuation was made in view of the expiration on March 31, 1978 of the Company's three-year sales agreement with the Japanese buyers and the anticipated shorter term of future sales agreements. Consolidated earnings for the year ended December 31, 1977 were reduced by $3,003,000 after applicable deferred income taxes as a result of this change. The effect of this change is to recognize revenue from the Company's coal operations on the basis of sales, commencing January 1, 1978 as compared to the basis of production for prior years.

(ii) Mine supplies
Mine supplies are valued at the lower of cost and net realizable value.

(iii) Houses for sale to employees
Houses for sale to employees are valued at the lower of cost and estimated net realizable value, less mortgages thereon.

(c) Depreciation and amortization

(i) In 1978 the Company adopted retroactively the recommendations issued by the Canadian Institute of Chartered Accountants for leases that transfer to the lessee substantially all the benefits and risks incident to ownership of property. Assets covered by these leases (classified as equipment under capital lease) are now accounted for as an acquisition of an asset and the incurrence of an obligation which is reduced by monthly lease payments net of imputed interest; previously monthly lease payments were charged to operating expenses. All other leases are accounted for as operating leases wherein lease payments are expensed as incurred.

(ii) Plant, equipment and equipment under capital lease are being depreciated on a straight-line basis over their productive lives, or in the case of each mining property to which they are appurtenances, over the productive life of the mine in terms of proven coal reserves, whichever is less.

(iii) Maintenance, repairs and renewals expenditures are expensed as incurred. Betterments are capitalized and included as additions to fixed assets.

(iv) Gains or losses on the sale or retirement of material items are taken into earnings. Gains or losses on other items are recorded as an adjustment of accumulated depreciation, in accordance with McIntyre's group depreciation policy.

(v) Development and preproduction expenditures relating to each mine are capitalized until the property is brought into production at or near its designated rate at which time they are amortized on a unit of production basis over the life of the mine in terms of proven reserves. The initial costs of the Smoky River Coal Division including infrastructure and start-up

expenses are being amortized on a unit of production basis over the estimated life of total proven coal reserves.

(vi) Overburden removal costs, except to the extent they are included in development costs of new mines, are charged to operating costs as incurred or at the average cost per ton based on the recoverable reserves of the specific mining units.

(d) Reclamation

The estimated cost of reclamation approved by provincial authorities at the outset of mining operations is provided for on a unit of production basis over the estimated life of each mine based on proven coal reserves. Additional expenditures incurred after the cessation of mining operations due to changes in the initial approved plan are expensed as incurred.

(e) Exploration

Exploration costs are charged to earnings as incurred.

(f) Interest

Interest is charged against earnings as incurred except interest on debt that can be specifically identified with a major capital project. No interest was capitalized in 1978 (1977 – $880,000).

(g) Foreign exchange

The Company's revenue from coal sales, which since April 1, 1978 are based on U.S. dollar prices, are reflected in the statement of consolidated earnings at the Canadian dollar exchange equivalent on the date of settlement.

Assets and liabilities to be settled in foreign currencies are translated to Canadian dollars at the rate of exchange prevailing at December 31, 1978. Unrealized gains or losses are included in consolidated earnings in the current year.

(h) Pensions

Current service costs are a current charge against earnings. Past service costs are amortized and funded over periods not exceeding fifteen years.

(i) Income taxes

The Company follows the tax allocation method of accounting whereby timing differences between reported and taxable income result in deferred taxes. Income taxes recoverable on losses are not recognized until realized.

2. Accounts Receivable

These are as follows:

	($000's omitted) 1978	1977
Coal settlements receivable	$ 3,458	$ –
Other receivables	3,263	2,107
	$ 6,721	$ 2,107

Coal settlement receivables include $2,708,000 in U.S. dollars.

3. Inventories and Mine Supplies

These are as follows:

	($000's omitted) 1978	1977
Specification grade coal	$ 9,811	$ 21,171
Mine supplies	6,191	6,204
Houses for sale to employees less mortgages thereon	776	100
	$ 16,778	$ 27,475

4. Investments

(i) Changes in the Company's investments in affiliated companies, accounted for by the equity method, are as follows:

	($000's omitted) Falconbridge		Madeleine	
	1978	1977	1978	1977
Investment — beginning of year	$ 99,635	$ 115,817	$ 1,163	$ 3,423
Equity (reduction) in undistributed earnings:				
— before extraordinary items	97	(12,417)	(607)	(110)
— extraordinary items	—	7,535	—	—
Writedown of investment	—	(11,300)	—	(2,150)
Investment — end of year	$ 99,732	$ 99,635	$ 556	$ 1,163
Shares held	1,848,414	1,848,414	1,712,208	1,712,208
Market value at December 31	$ 60,536	$ 38,355	$ 993	$ 1,130

$ 32.75

(ii) Summarized financial information for these two companies is presented below:

	($ 000's omitted) Falconbridge		Madeleine	
	1978	1977	1978	1977
Current assets	$ 348,939	$ 372,379	$ 862	$ 2,746
Other assets	517,640	515,774	3,992	4,016
	$ 866,579	$ 888,153	$ 4,854	$ 6,762
Current liabilities	$ 97,451	$ 119,968	$ 80	$ 361
Long-term liabilities	384,873	385,058	—	68
Shareholders' equity — preferred	75,000	75,000	—	—
— common	309,255	308,127	4,774	6,333
	$ 866,579	$ 888,153	$ 4,854	$ 6,762
Earnings (loss) attributable to common equity:				
— before extraordinary items	$ 768	$ (30,915)	$ (618)	$ (183)
— after extraordinary items	768	(10,677)	(618)	(303)
Dividends paid on common shares	$ —	$ 2,482	$ 941	$ —

5. Plant and Equipment

Plant and equipment at cost are as follows:

	($000's omitted) 1978	1977
Underground plant and equipment	$ 15,248	$ 15,091
Surface plant and equipment	69,534	68,253
Equipment under capital lease	5,952	5,952
Other	783	692
	91,517	89,988
Less accumulated depreciation	37,067	28,445
	$ 54,450	$ 61,543

6. Deferred Mine Development

Unamortized mine development costs are as follows:

	($000's omitted) 1978	1977
Producing properties	$ 25,539	$ 19,372
Non-producing properties	8,568	8,412
Initial costs, including infrastructure and start-up expenses	10,385	11,098
	$ 44,492	$ 38,882

7. **Long-Term Debt**

Long-term liabilities are as follows:

	($000's omitted) 1978	1977
Euro-U.S. Dollar term loan repayable February 22, 1979 — U.S. $31,561,824	$ 37,426	$ —
Canadian Dollar term loan repayable January 31, 1979	27,625	67,275
Obligation under capital lease	3,602	4,233
Coal sales contract advances	—	1,712
	68,653	73,220
Less current portion	625	2,344
	$ 68,028	$ 70,876

The Company's Bankers have informed the Company that appropriate long-term financing adequate to the Company's needs will continue to be provided, with security, but details of the renewals are not yet available.

8. **Income Taxes**

The tax effect of earned depletion and resource allowances has reduced the charge for deferred income taxes on operations during the year by $2,452,000 (1977 — $3,826,000).

At December 31, 1978 the Company had accumulated earned depletion allowances amounting to approximately $13,000,000 which are available to reduce future income tax charges.

9. **Extraordinary Items**

Extraordinary items consist of the following:

	($000's omitted) 1978	1977
Compensation for surrender of certain Crown coal leases	$ 1,454	$ —
Company's equity in the gain on sale of investment in Alminex Limited by Falconbridge Nickel Mines Limited	—	7,535
Writedown of investments in affiliated companies (Note 1(a))	—	(13,450)
	$ 1,454	$ (5,915)

10. **Earnings Per Share and Dividends Paid**

In calculating earnings per share and dividends paid the total issued shares have been reduced by 65,269 shares (1977 — 65,463 shares) being McIntyre's proportion of its own shares held by an affiliated company.

Exercise of the share options outstanding would not affect to any extent the earnings per share for the year ended December 31, 1978.

11. **Commitments and Contingencies**

(i) The Company has guaranteed mortgages amounting to $11,503,000 at December 31, 1978 in respect of employee housing in Grande Cache.

(ii) A long term operating lease agreement for the supply of unit-train rail cars for the transportation of coal provides for minimum rental charges of $1,090,000 per year.

(iii) The Company is obligated to pay approximately $500,000 for the balance of purchase of the shares of Copton Excol Limited, an 81.1% subsidiary of McIntyre, in the event that Copton Excol secures a contract for the sale of coal from its property.

(iv) In 1969 the Company contracted to supply coal to Canadian Utilities, Limited, to provide its requirements for fuel of contract specification at its thermal power generating plant at Smoky River, Alberta, for a period of 15 years commencing December, 1972 at a price of approximately 32 cents per long ton. That contract is renewable at the option of the purchaser at a nominal price for a further 15 years.

Alberta Power Limited, the assignee of Canadian Utilities, in 1973 commenced an action against the Company in the Supreme Court of Alberta claiming damages in the amount of $804,000 for costs allegedly incurred by it in connection with the supply and use of coal supplied by the Company to

December 31, 1973, and requesting certain declaratory and injunctive relief. The Company is defending the action. In the opinion of counsel, the plaintiff will not be successful in obtaining judgment of the amount of damages claimed or in obtaining an injunction. No provision therefor has been made in the accounts.

The Company maintains that it is legally bound under the contract to supply only by-product coal from its metallurgical coal mining and processing operations. It believes, on the basis of its by-product coal production since its metallurgical coal mining operation at Smoky River commenced in 1971, that there will not be sufficient amounts of specification by-product coal available to fulfill the requirements of Alberta Power. The Company is presently delivering by-product coal to Alberta Power on a month to month basis, at cost. McIntyre understands that Alberta Power has also been purchasing and utilizing and continues to purchase and utilize additional fuel. The parties are jointly investigating the technical and economic feasibility of utilizing all of the by-product coal produced by the Company from its Smoky River operation as a step towards the long-term rationalization of the power plant's fuel requirements. The results of those investigations are expected to be available in 1979 and will provide the basis for negotiations between the parties in respect of the fulfillment of this requirement.

(v) On June 1, 1974 Copton Excol Limited, an 81.1% subsidiary of McIntyre, entered into an agreement with Meadowlark Farms Inc., a wholly owned subsidiary of Amax Inc., to further explore and evaluate Copton's coal properties in the Smoky River region of Alberta in order to determine the economic feasibility of developing the properties for production. Under the terms of the agreement Meadowlark was to acquire a 50% interest in Copton's coal properties if, among other things, it delivered to Copton prior to May 31, 1976 a complete and detailed economic feasibility study in respect of Copton's coal properties on the basis of which it had to be prepared to proceed with the development of the properties to production. If it failed to do so the agreement terminated.

Prior to May 31, 1976 Meadowlark delivered to Copton a purported feasibility study which was reviewed by Copton with the assistance of independent engineering consultants. Based upon the opinions and information provided by these parties at that time counsel was of the opinion that the study submitted by Meadowlark did not qualify as a complete and detailed economic feasibility study within the terms of the agreement. Accordingly, on June 8, 1976 Meadowlark was advised in writing that the agreement had terminated.

In a counterclaim filed by Meadowlark in an action commenced by Copton on August 3, 1976 Meadowlark claims damages against Copton in the amount of $308,382,000 and also alleges, among other things, that McIntyre induced Copton to breach the agreement. Examinations for discovery in that action have now been substantially completed.

Based on the opinion of its counsel, McIntyre maintains that there is no justification for any claims against it and, accordingly, no provision for damages has been made in the accounts. Copton is also denying the claims made against it.

(vi) Company pension contribution costs for the year, including past service costs, were $288,000 (1977 – $708,000).

Total unfunded past service liability at December 31, 1978 amounted to $274,000 relating to improvements in plan benefits made in 1973 and 1975. The liability is being amortized by annual payments of $33,000.

12. **Capital Stock**

175,000 shares have been set aside under the Executive and Key Employees Stock Option Plan. Of these, 153,450 had been issued to December 31, 1978. At that date, options were outstanding on 18,000 shares of which options on 10,000 shares expired on February 19, 1979. The outstanding options on 8,000 shares were granted on October 21, 1977 at $25.18 per share and expire on October 19, 1987.

13. **Remuneration of Directors and Senior Officers**

Aggregate remuneration paid to directors and senior officers was $490,000 which compares with the 1977 remuneration total of $413,000.

McINTYRE MINES LIMITED

FIVE YEAR SUMMARY

Production	1978	1977	1976	1975	1974
Raw coal (long tons)	2,132,785	2,943,598	3,162,460	2,588,309	2,358,357
Clean coal (long tons)	1,316,000	1,740,415	1,864,630	1,680,068	1,528,268
Earnings ($000's omitted)					
Revenue (a)	$	$	$	$	$
— Coal sales	105,270	—	—	—	—
— Coal production	—	123,873	121,911	95,736	48,093
Less coal royalty	(4,118)	(5,036)	(2,602)	(206)	(171)
	101,152	118,837	119,309	95,530	47,922
Dividends from affiliates	342	924	2,448	2,277	5,324
Exploration	4,279	3,220	1,690	1,980	1,242
Interest expense	6,310	4,287	4,024	4,329	5,911
Depreciation	9,083	8,413	6,589	5,209	3,783
Amortization of deferred development	1,945	3,567	3,281	2,993	1,030
Deferred income taxes	712	2,920	3,026	4,600	—
Earnings (loss) from operations	(1,922)	5,907	10,610	13,960	5,733
Equity (reduction) in undistributed earnings of affiliates	(554)	(12,599)	2,608	(1,279)	6,676
Reduction in valuation of coal inventory	—	(3,003)	—	—	—
Extraordinary gains (losses)	1,454	(5,915)	2,741	4,600	—
Consolidated earnings (loss)	(1,022)	(15,610)	15,959	17,281	12,409
Per share (b)	($0.43)	($6.59)	$6.73	$7.29	$5.24
Dividends paid (b)	1,184	2,369	2,369	1,184	—
Per share (b)	$0.50	$1.00	$1.00	$0.50	—
Financial Position ($000's omitted)					
Working capital (deficiency)	10,614	12,183	1,000	(4,167)	13,230
Investments	100,288	100,798	119,240	116,917	118,168
Properties and plant	98,942	100,425	91,810	83,605	76,679
Coal sales contract advances, less current portion	—	—	1,266	7,229	12,416
Long-term debt	68,028	70,876	48,592	40,702	62,873
Shareholders' equity	143,834	146,029	164,070	150,481	134,383
Per share (b)	$60.71	$61.64	$69.26	$63.52	$56.73
Shareholders and Employees — December 31					
Total shares outstanding	2,434,482	2,434,482	2,434,482	2,434,482	2,434,482
Shareholders	2,513	2,737	2,720	2,819	3,039
Employees	822	998	950	850	724

(a) In 1978 coal sales revenues were calculated on a coal sales basis as compared to a coal production basis in prior years.

(b) Per share figures calculated on the basis of total shares outstanding less equity in own shares held by affiliate.

McINTYRE
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